NEI Canadian Equity RS Fund

Q4 2024 Commentary

NEI

Performance

The Fund (Series I) underperformed its benchmark over the quarter.

Returns

Fund	3 months	6 months	YTD	1 year	3 years	5 years	10 years	Since inception[1]
NEI Canadian Equity RS Fund Series I	1.80	12.57	18.94	18.94	9.73	11.82	8.54	N/A
NEI Canadian Equity RS Fund Series A	1.19	11.19	16.09	16.09	7.11	9.14	5.91	N/A
NEI Canadian Equity RS Fund Series F	1.50	11.88	17.52	17.52	8.42	10.49	7.21	N/A
Benchmark 1: S&P/TSX Composite TR Index	3.76	14.71	21.65	21.65	8.58	11.08	8.65	N/A

[1]Source: Morningstar. As of December 31, 2024. Since inception is only provided for Funds with less than 10 years of performance.

Portfolio commentary

Underperformance in the quarter was almost entirely due to a lack of exposure to select higher-growth technology investments including Shopify and Celestica. The negative attribution headwind was partially offset by strong performance from consumer staples holdings and no exposure to the real estate sector.

The Fund's top contributing investments in the quarter were iA Financial Corp Inc., Enbridge Inc. and Sun Life Financial. The largest detractors were CCL Industries, Toromont Industries and Quebecor Inc.

The sub-advisor initiated on three new investments, Rogers Communications, Richelieu Hardware and Alimentation Couche-Tard. The Fund exited TC Energy, AutoZone and UnitedHealth Group.

Communications services has been the worst performing sector of the TSX in the last quarter and year because of a price war over wireless phone plans, higher corporate borrowing costs, and stretched balance sheets of virtually all companies in the industry. While the three major players in the industry have fallen to multi-year lows, the sub-advisor has avoided most of the challenges with Quebecor being the Fund's only investment in the sector. The sub-advisor believes that prevailing valuations of the sector reflect a view that the duration of a price war will be indefinite - a sentiment that the sub-advisor does necessarily share. To that end, the Fund initiated on Rogers Communications in the quarter. Visibility on when the price war will end is low, but the sub-advisor feels an attractive valuation entry point, the lowest dividend payout ratio among Canada's 'Big 3', and the company's renewed discipline around capital spending constitute protection to the downside.

Richelieu Hardware is a distributor and manufacturer of specialty and decorative hardware for furniture, cabinets, doors, windows, and outdoor applications. The company has been a long time holding in the sub-advisor's Canadian Small Cap Strategy. The pandemic had boosted the company's earnings considerably, lending to strong share price performance in that time frame. However, since late 2023, Richelieu has seen a corresponding normalization of demand for its products as home renovation trends slowed down and the end consumer has been challenged financially. Without needing to predict when the renovation cycle could resume, the sub-advisor is comfortable with the longer-term potential of Richelieu. The company has a strong balance sheet (virtually no debt) and a track record of inorganic growth during times when organic growth is scarce. The sub-advisor took advantage of weaker results and share price to initiate a position.

Alimentation Couche-Tard is a leading convenience store operator in North America, Europe and Asia. It has had a history of making accretive acquisitions and leveraging its scale to extract operational synergies. Management has a history of reducing debt quickly after major acquisitions, and the low capital requirements for the business make it highly cash generative. The sub-advisor took advantage of better valuations for this company later in 2024 as it has seen some softness in results due to a challenged end customer. This purchase was funded by exits from AutoZone and UnitedHealth Group.

In Q4 the strategy exited TC Energy, concluding the sub-advisor's measured approach to selling over the course of a few months as the risk/reward in its shares continued to be unenticing. The proceeds from TC Energy went towards partially funding the initiation of the two companies mentioned previously.

While the broader economy in North America appears robust, the industrial economy has remained sluggish. This has shown through in the Fund, with transportation and heavy equipment companies reporting slowing earnings growth. The Fund continued to add to Toromont Industries and also started to add to the position in Canadian Pacific Kansas City (CPKC). The sub-advisor thinks both are among the highest-quality companies they can invest in, though the determining factor in how large of an investment to make in either of them is the market valuation. Following a long period of both being at decidedly higher valuations, both Toromont and CPKC have declined to more comfortable levels for larger weights in the Fund.

Outlook

Various macro-economic signals have been flashing “yellow” for some time, particularly for Canada, seemingly at odds with a strong equity market. The sub-advisor doesn’t try to predict recessions, economic growth or other metrics - but that is not to say they don’t notice things. While they are not calling for a recession, the sub-advisor certainly recognizes the risk that 2024 will be a hard year to replicate in 2025. They remain optimistic, largely due to the large and still persistent gap between the Canadian market and its U.S. counterpart on valuation. While valuation alone rarely protects downside entirely, they will say, in a world where downside comes from the twin risks of earnings and valuation, the sub-advisor certainly sees considerably less valuation downside risk in Canada.

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